

CH-file

Subject: Egypt: Economic Prospects Through The Year 2000

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DIRECTORATE OF INTELLIGENCE

11 January 1988

EGYPT: ECONOMIC PROSPECTS THROUGH THE YEAR 2000

Summary

Egypt's deep-seated economic difficulties will prevent the generation of economic momentum and higher living standards through the next decade. Rapid population growth, crumbling infrastructure, and gradually increasing defense expenditures mean that Egypt will have to run fast just to keep even. Egypt imports 60 percent of its food now, and this percentage is likely to grow as population outstrips output and standards of consumption slowly rise. Industrial expansion is likely to remain sluggish and foreign exchange earnings will remain a critical problem for a nation that imports \$10 billion in goods and exports only \$4 billion and that has to service a \$32 billion external debt.

The most likely scenario is that Egypt will continue to cope with these difficulties with pragmatic, middle-of-the-road policies. This "coping" scenario has about a 75 percent chance of prevailing. A much less likely scenario--with perhaps a 15 percent chance of occurring--is for significant unraveling. In this scenario, a stagnant economy and a government no longer able to honor the "social contract" welfare policies of the past provides the background for riots, a growing resort to unofficial and/or illegal markets, marked increases in prices, further chilling of the investment climate, and other factors contributing to instability. An even less likely scenario, with about a 10 percent chance, is for a coalescence of positive factors leading to self-reinforcing changes and reform.

US aid helps Egypt feed its growing population, rehabilitate important parts of the infrastructure, and acquire modern weapons, but several factors work against the translation of this aid into influence. US aid will have little clout because of the domestic political constraints on Cairo's embracing US suggestions; the ineffectual absorption mechanism represented by Egypt's bloated bureaucracy; and the sheer magnitude of the economic task.

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The Coping Scenario

Egypt's deep-seated economic difficulties probably will not cause an unraveling of the society by the year 2000, but they almost certainly will prevent the generation of economic momentum and higher living standards. Rapid population growth will offset substantial gains in industrial facilities, modern technology, and human skills. Egypt will have to run fast merely to keep even with the demands of its expanding population, sizable military establishment, deteriorating infrastructure, frustrated young people, and international creditors.

The most likely scenario--with perhaps a 75-percent chance of prevailing--is a pragmatic middle-of-the-road coping with economic problems. This coping scenario reflects a blend of Egypt's entrepreneurial spirit, bureaucratic obstructionism, and time-honored cultural and religious practices. Major elements in the economy would fit into this scenario as follows:

- Population will expand from 52 million in 1987 to 71 million in 2000, thus absorbing most of the government's energy in providing food, housing, education, and jobs for the one million people added every eight months. This population growth of 2.5 percent over the next 13 years would preempt practically all of the anticipated GNP growth of 3 percent. Although the government urges religious leaders and the media to explain the need for smaller families, it cannot itself launch an activist antinatal program because of the opposition of Muslim fundamentalists.
- The administrative bureaucracy of some 3 million persons will continue to resist reformist proposals for streamlining regulatory procedures and privatizing a broad range of economic activity.
- The administration of Mubarak and his successors in this period will manage to live with, but not solve, the problems of a crumbling infrastructure; water and sewage systems, roads and public transport

vehicles, housing, the electric power supply, and the telephone system are failing and rebuilding is slow. Projects financed by USAID and the World Bank will continue to prop up Cairo's efforts to keep support services at a tolerable level.

- The armed forces, which serve as the ultimate buttress of the regime, will require gradually increasing resources to build up military industry, purchase expensive modern weapons, and maintain, if not enhance, the perquisites of military personnel. These bedrock requirements should take a fairly constant 10 to 15 percent of GNP.
- In agriculture, population will continue to press against the essentially fixed supply of land and water. Historically a major food exporter, Egypt now imports 60 percent of its food and this percentage will grow slowly over the next decade as: (a) agricultural output increases by about 2 percent annually, somewhat less than population; and (b) standards of consumption gradually rise. The financially strapped and bureaucratically constipated government will at best be able to effect only a fraction of the reforms needed in agricultural procurement prices and the crop mix. A five-year drought in the Nile catchment area has caused an alarming drop in the water level of Lake Nasser, behind the Aswan High Dam. This presumably is a temporary situation but if the drought continues the authorities will have to cut the flow of irrigation water substantially by early 1989.
- Industry will present a mixed picture of entrepreneurial initiative in medium and small ventures and sluggish state operation of large-scale companies. Foreign capital will not be readily available because of the more attractive investment

opportunities in other Third World countries. Managers will experience continued difficulty in getting foreign exchange for needed industrial equipment, spare parts, raw materials, and technology. Output will expand on average by perhaps 3 to 5 percent.

- Sadat's dramatic "infitah" (opening to the West) policy has increased the importance of foreign exchanges earnings in a nation that imports \$10 billion in goods but exports only \$4 billion and that has to service a \$32 billion external debt. The annual gap is made up approximately as follows: \$3 billion in worker remittances coming back in official channels; \$1 billion in Suez Canal tolls; \$1 billion in tourist receipts; \$2 billion in U.S. support; and large intermittent grants and credits from oil-rich Arab nations, the World Bank, and the IMF. The coping scenario envisions these sources of assistance as a force normally pushing the economy toward the middle (i.e., the funds will generally increase under emergency conditions and dwindle under less pressing conditions).

Alternative Scenarios

An alternative unraveling scenario stands a much smaller chance of occurring, perhaps 15 percent. This pessimistic scenario would develop against a background of a stagnant economy and a weakened government that could no longer honor the "social contract" of minimum food supplies at low prices and other welfare benefits. The proximate cause of the unraveling might be major riots touched off by an injudicious government announcement of cuts in food subsidies, harangues in the mosques and marketplaces by fundamentalist preachers or a final victory by Khomeini in his war with Iraq. As the unraveling gathered momentum, all or some of the following developments might take place:

- a growing resort to unofficial and/or illegal markets to obtain necessities, marked increases in prices, and a

rush to convert financial assets into dollar form.

- a further chilling of the investment climate, affecting both local businessmen and foreign firms and bringing large new projects to a halt.
- a sharp drop in tourist numbers and revenues.
- an upsurge in religious fundamentalism within Egypt, a revival that could rend the fabric of law and order and spread to other Arab countries.
- a rekindling of hostility between Egypt and Israel.
- a reluctance on the part of the United States to continue the \$2 billion annual package of economic and military assistance;
- an opening of opportunities for Soviet initiatives in Egypt.
- a growing dilemma for the Egyptian armed forces, which cannot lightly discard many years of training on and integration of U.S. equipment.
- and, at some stage, the replacement of the present regime with a new military regime of fundamentalist leanings.

Under this scenario, the resilience and adaptability that characterized the coping scenario would be lost, at first gradually, then perhaps with a rush. Individuals and groups would face more privations, challenges, and uncertainties than they could handle. The confidence of the populace and the military establishment in the regime would wane as it too became overwhelmed by new problems and uncertainties. As people became mutinous at the loss of income, status, and psychological security, the effects would be felt in lower production in agriculture, industry, and services. The whole infrastructure of the economy and society--barely maintained under the coping scenario--would suddenly appear grossly inadequate to an aroused people.

A second alternative momentum scenario, with perhaps a 10 percent chance of occurring, would most plausibly have its source in some combination of higher oil earnings, worker remittances, tourist revenues, Suez tolls, and foreign aid. This added inflow of foreign exchange would depend on favorable international developments largely beyond Egypt's control. Such positive developments are more likely to originate in the fluid conditions of the international market than in the highly constrained domestic Egyptian economy. Once started, however, the process would rapidly lead to self-reinforcing changes inside Egypt:

- With additional funds available for industrial raw materials, agricultural chemicals, and transport vehicles, the economy quickly could put its considerable idle capacity to work and realize some of the gains from new technology.
- The government would have more maneuver room for implementing economic reforms, for example, adjusting farm procurement prices, reducing controls over business, and moving more vigorously to substitute gas for oil in the domestic economy.
- Both domestic entrepreneurs and foreign companies would sense a more promising environment for profits and for long-term investment.

Cairo could take advantage of a probably fleeting opportunity to make the most critical reforms and to shore up its shaky finances. Or Cairo could fritter away the opportunity in billion-dollar outlays for new military equipment and for overambitious land reclamation projects. (Table 1 compares the three scenarios in outline form.)

Implications for the United States

US aid by itself cannot produce an independent self-sustaining Egyptian economy by the year 2000. Rather, US aid will help feed the additional people, rehabilitate important parts of the infrastructure, and support the moderate acquisition of modern weapons. This view of US aid fits

comfortably into the middle-of-the-road coping scenario.

The US \$2 billion annual subsidy to the Egyptian economy does not give Washington a vise grip on Cairo's policy. It is extremely difficult to translate US aid into political clout because of:

- the political restrictions on Cairo in embracing US suggestions;
- the ineffectual aid "absorbing mechanism" represented by Egypt's bloated bureaucracy;
- the institutional constraints hobbling the US aid "disbursing mechanism"; and
- the sheer magnitude of the economic task itself, particularly the inexorable population growth.

The Soviet Union enjoyed a prominent position of influence in the Nasser era of Arab socialism, only to lose its influence under Sadat and his turn to the West. Moscow lacks the funds, the technology, and the administrative flexibility to compete with Western and Arab sources of economic support. Furthermore, the Egyptians have a deep personal dislike for the Russians. Only in the event of the unraveling scenario would Cairo likely solicit large-scale support from Moscow. Nevertheless, the Soviets will seek opportunities to follow up on their success last spring in negotiating a solution to the longstanding Egyptian-Soviet debt issue.

Egypt: Alternative Economic Scenarios, 1988-2000

<u>Item</u>	<u>Unraveling Scenario</u>	<u>Coping Scenario</u>	<u>Momentum Scenario</u>
Background	Crescendo of popular unrest and takeover by a military leadership with strong fundamentalist leanings	Mixture of good and bad economic events and continued ability of government to adjust to these events	Increase in oil earnings, worker remittances, and Suez revenues, which gives government maneuver space
Reconstruction of Economy Along Western Lines	Comes almost to halt as Western ties and support diminish	Proceeds unevenly on pragmatic basis	Picks up pace, with higher per capita net investment
Economic Role of Government	Recentralization on emergency basis	Sluggish bureaucratic management	Sponsoring of new initiatives
Environment for Investment	Disappearance of private initiatives in modern sector	Multiple obstacles to moving projects forward	Substantial reduction in obstacles to new ventures
Infrastructure	Near chaos in supply of utilities and maintenance of transport	Nip-and-tuck efforts to keep utilities and transport operating	Input of large resources; bottlenecks, as new demands on services arise

<u>Item</u>	<u>Unraveling Scenario</u>	<u>Coping Scenario</u>	<u>Momentum Scenario</u>
Stability of currency	Foreign exchange drought and domestic hyper- inflation; new government controls	Movement toward unified exchange rate; domestic price pressures ongoing price pressures	Smoother movement toward unified exchange rate
Support from United States	Rapid drop-off in willingness to make large grants emergency supplements	Continued support at \$2 billion annual level; long-term projects	Willingness to consider support of new
Relations with Israel	Rekindling of hostility relations	Cautious economic and political relations	Room for somewhat easier
Attitude of Egyptian Military	Dilemma: cannot lightly discard years of training with and integra- tion of U.S. equipment	Supportive of regime; enjoying an absolute budget priority at current level of outlays	Moderate pickup in military modernization projects
Average GNP Growth	Perhaps 1 percent	Perhaps 3 percent	Perhaps 5 percent

Central Intelligence Agency



Washington, D. C. 20505

DIRECTORATE OF INTELLIGENCE

13 January 1988

Egypt: Aid From Persian Gulf Arab States [REDACTED]

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Summary

The substantial financial assistance Egypt receives from the Persian Gulf states is likely to increase over the next year especially with the renewal of diplomatic ties and the hope that Egypt might provide security guarantees to the Gulf states. This Arab aid may reinforce the Mubarak regime's inclination to delay urgently needed economic reforms and decrease the impact of US cash assistance. [REDACTED]

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Bilateral financial aid to Egypt from the Persian Gulf Arab states has become an important source of funding since mid-1986 for the chronically cash-short Egyptian Government. The ad hoc and low-key nature of the aid flow makes an exact accounting difficult, but the Gulf Arabs--principally Saudi Arabia and Kuwait--have provided as much as \$1.1 billion since mid-1986. An additional amount, approximately \$235 million, has been provided by Kuwait and Saudi Arabia in the form of project or development assistance. Kuwait has provided \$35 million of that total since the Gulf states resumed diplomatic ties with Egypt in late 1987. [REDACTED]

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The timing of these transfers is as important as the magnitude of the aid. The first large disbursements began during the third quarter of 1986 and coincided with Egypt's protracted negotiations for an IMF-standby agreement. Cash support from the Gulf, combined with an extensive lobbying campaign in Western capitals by Mubarak and other high Egyptian officials, may have enabled Cairo to adopt a tougher negotiating stance with the IMF. Ultimately, Egypt obtained the soft standby program it desired. Some aid payments appear linked to important deadlines for Egyptian foreign debt obligations such as US Foreign Military

This memorandum was prepared by [REDACTED]

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[REDACTED] Office of Near Eastern and South Asian Analysis.
Questions and comments should be addressed to the Chief, Arab-
Israeli Division, [REDACTED]

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Sales payments and purchase of Mirage aircraft from France.

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View from the Gulf

Egypt's position as the largest Arab state guarantees its importance in the eyes of the Gulf states. The financial flows to Egypt are in keeping with their longstanding interest in preserving a politically stable and moderate regime in Cairo. Moreover, private capital from the Gulf continues to flow into Egypt, and the desire to maintain a favorable investment climate for these funds is probably an important consideration for Gulf donors. Finally, [redacted] an expanding role for Egypt in the Gulf as a counterweight to Iran suggest that the Gulf states are willing to exchange financial aid for Egyptian security guarantees. Egypt, however, is unlikely to provide such guarantees unless the Persian Gulf states were to significantly increase aid transfers. [redacted]

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Implications for the US

With the resumption of formal diplomatic ties between the Gulf states and Cairo, and as long as the Iranian threat persists, financial assistance to Egypt probably will increase modestly and become more visible. This will diminish the importance of US cash assistance and may convince Cairo that it can postpone economic reforms. [redacted]

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